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OPINION

Markets Insight

State Street chief Cyrus Taraporevala: my 5 predictions for asset management in 2029

'The industry is locked in a Darwinian struggle that will reshape the competitive landscape'

CYRUS TARAPOREVALA

The current pressures on the asset management industry remind me of the old line about reaching a historic crossroads, where one path leads to despair and the other to total extinction.

Faced with slower inflows and fee compression, as well as rising costs, asset managers are locked in a Darwinian struggle that will reshape the competitive landscape of the industry in 10 years.

Bill Gates, the billionaire founder of Microsoft, has said that we tend to overestimate the change that will happen in the next two years, yet underestimate the change that will happen over a decade.

Where will the industry be in 10 years' time? Here are my five predictions for 2029. I do not aspire to get all five correct — my goal is to develop our thinking about the implications for the industry's current priorities.

First, deflation will be investors' biggest challenge. Factors such as technology, ageing populations and globalisation will continue to drive the world's economy.

Today, inflation, wage growth, and productivity growth are still slow, despite a decade of extraordinary monetary stimulus. Global growth continues to struggle to reach "escape velocity" as it has since the global financial crisis.

Meanwhile, the labour force participation rate continues to decline. Up to a quarter of men in prime working years in the US are expected not to be working by 2050, as automation bites harder.

Such a protracted slower environment will make saving for retirement even more difficult. Already a quarter of global debt markets trade at negative rates — what if that rose to 50 per cent by 2029?

Investors will probably take on more risk and complexity, with the risk of leverage-induced bubbles far higher.

Second, China will dominate. The rise of Asia will shift the balance of industry power, and by 2029 the largest asset manager in the world will be Chinese. Time, scale and momentum are on China's side.

Assets under management in the country are estimated to grow at more than 17 per cent annually over the next five years. Chinese mutual funds hold just 8 per cent of personal financial assets today. There is another $4.5tn in the domestic shadow banking system, according to consultancy McKinsey, which will probably seek a new home in funds as regulators take measures to limit the sector.

Chinese asset managers could leapfrog their western competitors through digital disruption, or they could scale up even more quickly by buying large foreign asset managers. China's full emergence into the global capital markets and the rise of Chinese mega asset managers will be the biggest regional shift in the history of asset management.

Third, passive will overtake active. Today's global mix — 25 per cent of assets managed passively versus 75 per cent active — will flip.

We are starting to see the switch in US equities, but fixed income will be affected as well. Active managers who sell "beta", or index return, dressed up as "alpha", or outperformance, will be disrupted out of existence.

As technology makes markets and access to information more efficient, asset allocation will become the new alpha. Portfolios will be constructed with a combination of exposures to traditional beta, together with long-term and durable investment factors such as momentum (hot stocks continue to outperform) and size (stocks with a small market capitalisation do better). These will be combined with true sources of manager outperformance — which will be even more scarce and precious 10 years from now.

Fourth, environmental, social and governance (ESG) investment will become business as usual. In 2029, we will no longer be talking about ESG in terms of standalone investment strategies. The quality and consistency of such data and analytics will advance to the point where they will be fully incorporated by portfolio managers into their investment processes across all asset classes.

These value drivers will become part of mainstream investment analysis and security selection. A company's ESG rating will be as important as its credit rating.

Fifth, climate change will be the biggest wild card for investors, involving the biggest challenge not only for our industry but for human life itself. The question is whether our industry will take seriously the value creation, or destruction, potential that climate change brings.

At the moment our industry still looks at climate as a matter of customer preference, rather than through the lens of investment value. It is important to seize the opportunity to deploy capital to support climate change solutions.

In a world where countries and governments are turning inward, global capital flows are inherently outward-looking and suited to address cross-border challenges such as climate change, technology disruption and ageing populations.

This is our moment to show the true value we can bring to the future of investing by embracing a shift in the way we operate as an industry.

The writer is chief executive at State Street Global Advisors